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IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 29.1.2007

CORAM

THE HON'BLE MR.JUSTICE P.D.DINAKARAN
AND
THE HON'BLE MRS.JUSTICE CHITRA VENKATARAMAN

T.C.(A) Nos.74 and 75 of 2003

Commissioner of Income Tax
Chennai .. Appellant

Vs.

m/s.Southern Petrochemical Industries
Corporation Ltd.,Madras-32 .. Respondent

Appeal under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Madras 'C' Bench dated 25.2.2003 in ITA No.3589 & 1088 (Mds)/90 for the assessment years 1986-87 & 1987-88 against the order passed by Commissioner of Income Tax (Appeals) II Madras - 34, dated 29.08.1990, 26.10.1989 in IT/WT/GT/Appeal No.60/90-91 and 23/89/90 against the assessment order of Assistant Commissioner of Income-Tax, Central Circle II (S) Madras - 34 dated 29.03.1990 and 14.03.1999 in PAN/G.I.R.No.47-031-CY-0851/87-88 respectively.

For Appellant : Mrs.Pushya Sitaraman, Sr.SC for IT.
For Respondent : Mr.R.Vijayaraghavan

J U D G M E N T

(Delivered by P.D.DINAKARAN, J.)

The Revenue has preferred the above tax case appeal against the order of the Income-tax Appellate Tribunal dated 25.2.2003 in ITA No.1088 & 3589/Mds/1990 for the assessment years 1986-87 and 1987-88 raising the following substantial questions of law for consideration:

1. Whether in the facts and circumstances of the case, the Tribunal was right in holding that depreciation should be allowed on stand by spare parts even though they were not taken for use during the year?

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> 2. Whether in the facts and circumstances of the case, the Tribunal was right in holding that the expenses related to obtaining fixed deposits from the public is a revenue expenditure liable for deduction?

2. The facts, in brief, are as under:

2.1. The assessment years with which we are concerned are 1986-87 and 1987-88. The assessee filed its returns, inter alia, claiming depreciation on standby items such as, spare parts in respect of critical parts of plant and machinery for both the assessment years. In so far as the assessment year 1987-88 is concerned, the assessee claimed deduction of expenses relating to the issue of fixed deposits as revenue expenditure. The assessing officer, however, rejected the said claims of the assessee.

2.2. On appeal, the Commissioner of Income-tax (Appeals), as regards depreciation on stand-by items, held that they must be treated as machinery being put to use in the business of the assessee and depreciation should be allowed on them. In respect of deduction on expenses relating to obtaining fixed deposits, the Commissioner of Income-tax (Appeals) held that the expenses were relatable to issue of fixed deposits from public in order to augment working capital of the assessee and the expenses incurred for raising working capital is revenue expenditure and accordingly, deleted the addition made by the assessing officer.

2.3. The Appellate Tribunal, on appeal by the Revenue, held that the depreciation should be granted on standby items and the expenses relating to fixed deposits should also be allowed as revenue expenditure.

2.4. Aggrieved by the order of the Appellate Tribunal, the Revenue has come forward with the appeals raising the questions of law referred to above.

3.1. Regarding the 1st question, viz.,

> "Whether in the facts and circumstances of the case, the Tribunal was right in holding that depreciation should be allowed on stand by spare parts even though they were not taken for use during the year?"

at the outset, we are of the view that the question is not happily framed and we reframe the question as under:

> "Whether in the facts and circumstances of the case, the Tribunal was right in holding that depreciation should be allowed on spare parts which are standby items even though they were not taken for use during the year?"

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3.2. Undisputedly, as found in the order of the Appellate Tribunal, the standby items are assets acquired by the assessee and kept in readiness for use whenever the machinery that is regularly used goes out of action or requires repairs. Before going into the the question whether depreciation on standby items is allowable, it is useful to refer the law on this subject.

3.3. Section 32 of the Act reads as follows:

> "32. Depreciation – (1) In respect of depreciation of
> (i) buildings, machinery, plant or furniture being tangible assets;
> (ii) know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after the 1st day of April 1998,
>
> owned wholly or partly, by the assessee and used for the purpose of the business or profession, the following deductions shall be allowed -- ..."

3.4. In CIT v. Viswanatha Bhaskar Sathe (5 ITR 621), the Bombay High Court had an occasion to deal with section 10(2)(vi) of the Income-tax Act, 1922 which is similar to section 32 of the Income-tax Act, 1961. In that case, the factory of the assessee was not employed in the work of ginning and the assessee claimed depreciation. While interpreting the word, 'used' found in section 10(2)(vi) of the 1922 Act, the Bombay High Court held as under:

> "But I think that the word 'used in this section may be given a wider meaning and embraces passive as well as active user. Machinery which is kept idle may well depreciate, particularly during the monsoon season. It seems to me that the ultimate test is, whether, without the particular user of the machinery relied upon, the profits sought to be taxed could have been made and as I read the agreement in the case, the profits of the assessee during the year under assessment could not have been earned except by his maintaining his factory in good working order and that involves the user of the factory and the machinery."

3.5. In Liquidators of Pursa Ltd. v. Commissioner of Income-tax (Appeals) (25 ITR 265), in construing the expression 'used for the purposes of the business' found in section 10(2)(iv) of the 1922 Act, the Supreme Court observed as follows:

> "The words 'used for the purposes of the business' in section 10(2)(iv) of the Indian Income-tax Act, 1922, mean used for the purpose of enabling the owner to carry on the business and earn profits in the business. In other words, the machinery

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or plant must be used for the purposes of that business which is actually carried on and the profits of which are assessable under section 10(1).

The word 'used' has been read in some of the pool cases in a wide sense so as to include a passive as well as active user. It is not necessary, for the purposes of the present appeal, to express any opinion on that point on which the High Courts have expressed different views. It is however, clear that in order to attract the operation of clauses (v), (vi) and (vii) the machinery and plant must be such as were used in whatever sense that word is taken at least for a part of the accounting year. If the machinery and plant have not at all been used at any time during the accounting year no allowance can be claimed under clause (vii) in respect of them and the second proviso also does not come into operation".

3.6.1. The above cases came to be referred before this Court in C.I.T. v. Vayithri Plantations Ltd. (128 ITR 675) which arose out of almost similar set of facts seeking grant of development rebate. In that case, the assessee company completed the construction of building and installation of machinery before 31.3.1971, but could not start regular manufacture with the aid of that machinery because of frequent labour unrest and the assessee claimed development rebate in respect of machinery, but the assessing officer rejected the claim on the ground that the machinery in respect of which the claim had been made had only been installed and had not been used in the year of account and hence, the amount would be allowed as a deduction in the next year when the machinery was actually brought into use. However, the Commissioner as well as the Tribunal directed the grant of allowance.

3.6.2. In such circumstances, this Court, after elaborately discussing the point, held as follows:

"... the machinery could be 'used' for the purposes of the business so long as it is kept ready for such user. Any 'forced idleness' of the machinery cannot disentitle the assessees from getting the benefit of the allowance. In the present case, from the directors' report, which have already been extracted and the contents of which are not at all in dispute, it is clear that the assessee was prevented from using the machinery because of the frequent labour unrest. In these circumstances, we consider that, in the present case, the assessee would be eligible for the allowance as the machinery was kept ready for use and in that sense had been 'used' for the purpose of that business, as contemplated under the provision."

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3.7. Applying the ratio as laid down above to the facts of the case, we are of the view that the assessee is entitled to depreciation on spare parts which are standby items even though they were not taken for use during the accounting year. Accordingly, the 1st question of law is answered in the affirmative and against the Revenue.

4.1. The second question, viz.,

> "Whether in the facts and circumstances of the case, the Tribunal was right in holding that the expenses related to obtaining fixed deposits from the public is a revenue expenditure liable for deduction?"

deals with the deduction of expenses relating to obtaining fixed deposits from the public as revenue expenditure. The Tribunal, finding that such expenses are closely linked with the business requirement of funds, allowed the claim of the assessee.

4.2. For deciding the issue that the expenses relating to obtaining fixed deposits are closely linked with the business requirement of the assessee, it is apposite to have a cursory look on the decided case-laws on this point. In India Cements Ltd. v. C.I.T. (60 ITR 52), while deciding the nature of the amount spent towards stamps, registration fees, lawyer's fees, etc., for obtaining loan, the Supreme Court observed as follows:

> "A loan may be intended to be used for the purchase of raw material when it is negotiated, but the company may, after raising the loan, change its mind and spend it on securing capital assets. Is the purpose at the time the loan is negotiated to be taken into consideration or the purpose for which it is actually used? ..... the purpose for which the new loan was required was irrelevant to the consideration of the question whether the expenditure for obtaining the loan was revenue expenditure or capital expenditure.
>
> To summarise this part of the case, we are of the opinion that: (a) the loan obtained is not an asset or advantage of an enduring nature; (b) that the expenditure was made for securing the use of money for a certain period; and (c) that it is irrelevant to consider the object with which the loan was obtained."

Observing so, the Supreme Court held that the act of borrowing money was incidental to the carrying on of business, the loan obtained was not an asset or an advantage of enduring nature, the expenditure was made for securing the use of money for a certain period and it was irrelevant to consider the object with which the loan was obtained and therefore, the amount spent was not in the nature of capital expenditure and was laid out or expended wholly and exclusively for the purpose of the assessee's business and was therefore allowable as a deduction. The Apex Court also held that obtaining capital by issue of shares is different from obtaining loan by debentures.

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4.3. The Bombay High Court in C.I.T. v. Mahindra Ugine and Steel Co. Ltd. (250 ITR 696) considered the allowability of stamp duty paid on debenture issue as business expenditure and held that the expenditure is revenue in nature. In that case, attack was made by the Revenue on the strength of section 35D of the Act which deals with amortisation of certain preliminary expenses, and the Bombay High Court held that

> "Section 35D deals with amortisation of certain preliminary expenses. Under section 35D(1)(ii), it is laid down that after the commencement of the business any expenditure as described in section 35D(2), which is incurred in connection with the extension of the industrial undertaking or with regard to setting up a new industrial unit then the assessee shall be allowed a deduction at an amount equal to one-tenth of such expenditure for each of the ten successive previous years beginning with the previous year in which the business commences or the previous year in which expansion of the industrial undertaking is completed, etc. In the present case, on the facts, the Tribunal has found that the object of the debenture issue was to meet the working capital requirement of the assessee and, therefore, the expenditure was considered to be a revenue expenditure."

4.4. In C.I.T. v. Investment Trust of India Ltd. (264 ITR 506) this Court held that the expenditure on advertisements in newspapers inviting fixed deposits from the public is allowable in the words:

> "In view of the provisions contained in section 58A of the Companies Act, 1956, the assessee company had to advertise the notice calling for deposits and if there was any breach, the assessee was liable to be proceeded against under the relevant provisions of the 1956 Act. Section 37(3A) was introduced to curb extravagant and socially wasteful expenditure on advertisement at the cost of the exchequer. The assessee had incurred the expenditure on advertisements for collecting fixed deposits and the advertisements were statutory advertisements and therefore, the provisions of section 37(3A) read with section 37(3B) were not applicable to the said expenditure."

4.5. Considering the ratio laid down in the above said decisions, we are of the view that when the Tribunal has recorded a finding that the expenses relating to obtaining fixed deposits are closely linked with the business requirement of the assessee, such expenses are allowable expenses. We therefore hold that the Tribunal was right in holding that the expenses for obtaining fixed deposits from the public is revenue in nature. Accordingly, we answer the second question in the affirmative and against the Revenue.

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In fine, both the questions are answered in the affirmative and against the Revenue. The appeal stands dismissed. No costs.

Sd/
Asst.Registrar

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Sub Asst.Registrar

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To

1.The Assistant Registrar,
Income Tax Appellate Tribunal
Rajaji Bhavan, III Floor,
Besant Nagar, Chennai - 90.

2.The Commissioner of Income-Tax
(Appeals-II), Madras.34

3. The Asst. Commissioner
of Income-tax, Central Circle II(5),
Madras.

4. The Commissioner of Income Tax,
Chennai.

1 cc To Mr.Pushya Sitaraman, Advocate, SR.5617.
1 cc To M/S.R.Vijayaraghavan, Advocate, SR.5593.

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